

VZCZCXRO1341
RR RUEHDBU
DE RUEHKB #1800/01 3450633
ZNY CCCCC ZZH
R 110633Z DEC 06
FM AMEMBASSY BAKU
TO RUEHC/SECSTATE WASHDC 1944
INFO RUCNCIS/CIS COLLECTIVE
RUEHAK/AMEMBASSY ANKARA 1900
RUCPDOG/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEAIIA/CIA WASHINGTON DC

C O N F I D E N T I A L SECTION 01 OF 03 BAKU 001800

SIPDIS

SIPDIS

E.O. 12958: DECL: 12/15/2016

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [AJ](#) [EINV](#)

SUBJECT: 2007 STATE BUDGET FORESEES 60 PERCENT INCREASE IN
GOVERNMENT SPENDING

REF: BAKU 1476

Classified By: DCM JASON HYLAND, PER REASONS 1.4 (B, D)

11. (C) SUMMARY. Azerbaijan's Parliament approved the 2007 State Budget on November 28. Compared to the 2006 budget, the 2007 budget plans for a 57 percent increase in revenues, a 60 percent increase in expenditures, and a small budget deficit. Government revenues are expected to total USD 6.1 billion, while government expenditures will total USD 6.6 billion, leading to a budget deficit of USD 435 million. The State Oil Fund will contribute more than USD 650 million to the budget for 2007, nearly 40 percent of its total current assets of USD 1.5 billion. As part of overall government revenues, however, the reliance on SOFAZ budgetary support has decreased by more than seven percent compared to its 2006 budget contributions. The GOAJ expects that a growing portion of the 2007 State Budget revenue will come from the energy sector, including increased oil tax revenues. Despite many international observers' fears of massive, out-of-control government spending, the 2007 state budget reflects a slightly more disciplined approach to maintaining Azerbaijan's growing economic machine. Finance Minister Samir Sharifov told the Ambassador that he negotiated hard to keep spending under control, fighting many line ministries pushing for more money and a larger part of the budget pie. The 2007 budget earmarks sizable increases of more than 50 percent in the education and health areas, reflecting the GOAJ's interest in improving the daily lives of Azerbaijanis.
END SUMMARY.

12. (SBU) We have reviewed Azerbaijan's 2007 State Budget document (presented to Parliament on November 8) and offer our initial analysis below. The Government of Azerbaijan, however, will not publish the budget breakdown by ministry and agency until early 2007 by Presidential Decree. Once this information is available, we will provide additional budgetary analysis. Azerbaijan's Gross Domestic Product in 2007 is forecasted to total USD 25 billion. All figures are in millions of U.S. Dollars. (NOTE: For 2007 budget calculations, we used the new Azerbaijani manat 0.87 equals USD 1 exchange rate.) All percentage changes are at the nominal rate unless otherwise noted.

	2007	2006	%Change	%GDP
Revenues:	6,136	3,586	57	24.5
Expenditures:	6,571	3,783	60	26.3
Budget Deficit:	435	198	91	1.7

BUDGET REVENUES

13. (SBU) In 2007, the GOAJ predicts budget revenues to

increase by 57 percent compared with 2006, including a 121 percent increase in "profit taxes" and a 22 percent increase in Customs revenues. Budget revenues are projected to be 24.54 percent of 2007 GDP, an increase of nearly one percent compared to 2006. As in 2006, the State Oil Fund (SOFAZ) is contributing more than USD 600 million to the budget for 2007; nearly one-third of its total current assets. According to the 2007 Budget Decree, major increases in revenues are indicated below:

	2007	2006	%Change
Personal Income Tax:	632	418	38
Profit Taxes:	2,409	915	141
SOFAZ Transfers:	672	616	9

Main Items in Budget Revenues:

	% of Total Revenue	% of GDP
Profit Taxes:	39.26	9.64
VAT:	18.55	4.55
Transfers from SOFAZ:	10.96	2.69
Personal Income Taxes:	10.31	2.53

14. (SBU) The GOAJ expects that a growing portion of the 2007 State Budget revenues will come from the energy sector, including increased oil tax revenues. The economy continues to expand at a rapid pace (2006 GDP growth is estimated to be more than 30 percent) contributing to higher government revenues. In addition, the Ministry of Finance has increased contributions from the State Customs Committee and the Ministry of Taxation, capturing more revenues. Since early 2006, the GOAJ has also made extensive efforts to improve tax collection procedures and increase the number of tax payers.

BAKU 00001800 002 OF 003

The 41 percent increase of Personal Income Tax represents Azerbaijani citizens' growing personal wealth and rising salaries, as well as growing GOAJ collection efforts.

BUDGET EXPENDITURES

15. (SBU) Azerbaijan's 2007 State Budget expenditures are predicted to be 60 percent higher than 2006 budget expenditures, totaling 26.29 percent of GDP. As in previous budgets, the government proposes major increases in the areas of defense, education, social protection/social security, and industry, construction and mineral resources.

	2007	2006	%Change
General Government Services:	569	511	8
Defense:	916	618	45
Education:	843	501	54
Social Protection and Social Security:	607	426	30
Industry, Construction and Mineral Resources:	1,749	647	148
Courts, Law Enforcement:	504	270	62
Health:	310	150	79
	Percentage of Total Expenditures		% of GDP
General Government Services:	8.66		2.28
Defense:	13.94		3.67
Education:	12.83		3.37
Social Protection and Social Security:	9.23		2.43
Industry, Construction and Mineral Resources:	26.63		7.00
Courts, Law Enforcement:	7.67		2.02
Health:	4.72		1.24

¶16. (SBU) While defense expenditures increased again in the 2007 budget reaching more than USD 900 million, the largest government expenditure remains the "Industry, Construction and Mineral Resources" area. Based on the current budget document, however, it is not possible to determine how much of the USD 1.75 billion budget (an increase of 148 percent) for this area will be actually used for government ministry expenses and large capital expenditures. In 2006, the Industry, Construction and Mineral Resources received USD 647 million, an increase of 267 percent compared to the 2005 state budget. The increase in this area of the budget also indicates the GOAJ's continuing efforts to modernize rapidly.

SOFAZ TRANSFERS

¶17. (SBU) As in 2006, the State Oil Fund is contributing more than USD 650 million to the budget for 2007, nearly 40 percent of its total current assets of USD 1.5 billion. As part of overall government revenues, however, the reliance on SOFAZ budgetary support has decreased by more than seven percent compared to its 2006 budget contributions. In 2007, SOFAZ should receive approximately USD 5 billion in oil revenue with the completion of the BTC pipeline and increased oil exports from the Azeri-Chirag-Guneshli field.

BUDGET DEFICIT

¶18. (SBU) The budget deficit predicted in the 2007 State Budget increases to USD 436 million, up from USD 175 million in 2006. The budget deficit, however, is relatively small at only 1.74 percent of GDP. In addition, the GOAJ maintains little external debt.

PARLIAMENT DEBATES BUDGET

¶19. (SBU) After weeks of discussion in Parliament, the 2007 budget passed on November 28 with a vote of 94 to 3. (NOTE: 28 Members of Parliament (MPs) did not vote, a not unusual occurrence, according to several opposition MPs.) Opposition MP Panah Huseyn, who was in a group of five Musavat party MPs who walked out during a session in which the draft budget was being discussed, told the press that the budget was "not

BAKU 00001800 003 OF 003

transparent and was corrupt, designed to plunder the national riches." In a November 30 meeting with visiting FAS Counselor, MP and Economic Policy Commission Chair Ziyad Samadzade said that the main goal of the 2007 budget was to diversify Azerbaijan's economy, to "lessen the country's dependence on the oil sector." In addition, Samadzade said he hoped that aiming to develop a variety of sectors would bring Azerbaijan's economy "closer to international standards." Samadzade said that the GOAJ needed tighter budget control, and now that the budget has passed, he said that he anticipates Parliament discussing the budget system during several December sessions.

COMMENT

¶19. (C) Despite many international observers' fears of massive, out-of-control government spending, the 2007 state budget reflects a slightly more disciplined approach to maintaining Azerbaijan's growing economic machine. Finance Minister Samir Sharifov told the Ambassador that he negotiated hard to keep spending under control, fighting many line ministries pushing for more money and a larger part of the budget pie. Minister Sharifov, a relative budget hawk in Azerbaijan, is concerned that large government spending could

lead to higher inflation and macroeconomic distortion. Azerbaijan, with its vast energy resources now more readily exportable to international markets amid higher prices, would have the cash flow to increase dramatically budgetary spending.

¶10. (C) While not outlined in the budget document, the GOAJ will continue to raise government salaries incrementally, adding to inflationary pressures. On a positive note, the 2007 budget earmarks sizable increases in the education and health areas. Both areas will receive increases of more than 50 percent compared to 2006, reflecting the GOAJ's interest in improving the daily lives of Azerbaijanis. In addition, the GOAJ's decreasing reliance on the State Oil Fund for budgetary support is a good sign and represents a growing economy that could translate into more funds being available at the Oil Fund for "future generations," a key Oil Fund objective.
HYLAND